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Office of Exemption Determinations  
EBSA (Attention: D- 11712, 11713, 11850)  
U.S. Department of Labor  
200 Constitution Avenue NW  
Suite 400  
Washington, DC 20210

Re: RIN 1210-AB82

Ladies and Gentlemen:

The National Employment Law Project (“NELP”) submits these comments in response to the Department of Labor’s (the “Department”) August 31, 2017, notice of proposed amendments to PTE 2016-01, PTE 2016-02, and PTE 84-24 (the “NPRM”). The proposed amendments would delay – in some cases *further* delay – the applicability date of certain key conditions (collectively the “Conditions”) to new and recently revised administrative class exemptions (each one, a prohibited transaction exemption or “PTE”) to the prohibited transaction provisions found in ERISA and the Internal Revenue Code (the “Code”). The Department has requested comment on its proposal to delay application of the Conditions for 18 months, until July 1, 2019, and, additionally, whether a different delay approach – such as tying the delay period to the occurrence of a specific event – would be preferable.

NELP is a non-profit research and policy organization that for more than 45 years has advocated for the employment and labor rights of low-wage workers. Because these workers need the protections afforded by the full set of the Conditions as soon as possible, we strongly oppose any further delay of the Conditions’ application. Furthermore, we dispute the accuracy of the regulatory impact analysis contained in the NPRM, and believe that the proposed amendments cannot be economically justified. Indeed, if the rule were finalized in its current form, it would lack a sufficiently rational basis to survive judicial review under Section 706 of the APA.

## Introduction

While we believe that the Department has not adequately supported a material delay of any of the Conditions – given each one’s importance to the impartial conduct standards (the “ICSs”) that underpin the PTEs<sup>1</sup> – delay of the condition that financial institutions represent their investment-advice fiduciaries’ adherence to the ICSs in a written contract (the “Contract Condition”) is especially unjustified.<sup>2</sup> Without any meaningful enforcement mechanism, which does not exist in the IRA market without the Contract Condition, there is no basis to conclude – as the Department erroneously does – that a significant number of investment-advice fiduciaries will adhere to the ICSs when advising IRA owners during the period of the proposed delay. And, without adherence to the ICSs, there is no reason to believe that the well-documented and harmful conflicts of interest that persist in this segment of the financial-advice market will be substantially mitigated.

The Department fails to offer evidence to support its assumption otherwise. As explained below, its recourse to the excise tax available under the Code is insufficient. Only 15 months ago the Department explained at length why the excise tax is an inadequate enforcement mechanism, providing little or no deterrent value.<sup>3</sup> Nowhere in the NPRM does the Department now disavow this analysis or present any change in circumstances. Nor could it do so. The excise tax, which requires no more than disgorgement of ill-gotten profits, relies on *self*-reporting to the IRS. In this context, the Department concluded only recently that the Contract Condition provides a “critical safeguard with respect to investments in IRAs and non-ERISA plans.”<sup>4</sup>

The Department did not use this language in passing. In the preamble to the Best Interest Contract Exemption, it used the word “critical” no fewer than *ten* times in connection with the Contract Condition,<sup>5</sup> including to describe the Contract Condition’s importance to the Secretary of Labor’s findings that the PTE meets certain statutory requirements.<sup>6</sup> The Department called the Contract Condition a “powerful incentive” for adherence to the ICSs,<sup>7</sup> and concluded, “[t]he exemption’s enforceability, and the potential for liability, are critical to ensuring adherence to the exemption’s stringent standards and protections, notwithstanding the competing pull of the conflicts of interest associated with the covered compensation structures.”<sup>8</sup>

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<sup>1</sup> As described further below, the ICSs condition relief under the PTEs on the provision of investment advice that is only in the best interest of the client, the receipt of only reasonable compensation, and the avoidance of misleading statements. *See, e.g.*, Best Interest Contract Exemption, 81 Fed. Reg. 21002, 21077 (Apr. 8, 2016)

<sup>2</sup> The other principal Conditions are the condition that financial institutions: (1) Represent in writing that they and their advisers are fiduciaries, *see, e.g., id.*; (2) Warrant the creation of policies and procedures designed to ensure that advisers meet the ICSs and also that the institution does not rely on certain performance or sales targets to incentivize its advisers, *see, e.g., id.*; and (3) disclose, among other things, any material conflicts of interest and the nature of conflicting payments, *see, e.g. id.* at 21078.

<sup>3</sup> *See id.* at 21022.

<sup>4</sup> *Id.* at 21020.

<sup>5</sup> *See, e.g., id.* at 21008 ; *id.* at 21021; *id.* at 21033.

<sup>6</sup> *Id.* at 21060 (“The conditions [including the Contract Condition] were critical to the Secretary of Labor’s ability to make the required findings under ERISA section 408(a) and Code section 4975(c)(2) that the exemption is in the interests of plans, their participants and beneficiaries, and IRAs, that the exemption is protective of their interests, and that the exemption is administratively feasible.”)

<sup>7</sup> *Id.* at 21021 *id.* at 21022; *id.* at 21024.

<sup>8</sup> *Id.* at 21021.

As much as we all would probably prefer a world in which voluntary compliance were to entail meaningful, substantial compliance, the Department's own analysis – as well as everyday experience and common sense – belies any such fantasy.

Balanced against the losses that retirement savers will incur if the Department eliminates investment-adviser fiduciaries' incentive to meet the ICSs, are the minimal costs associated with compliance with the Contract Condition. Financial institutions need only include a short representation – that their investment-adviser fiduciaries will adhere to the ICSs – to the contracts that they already enter into with clients.

#### The Conditions Provide Indispensable Protection to Retirement Savers

As we explained in our July 21 response to the Department's request for information, "Congress prohibited the 'prohibited transactions' for a reason. The conflicts of interest inherent to them are inconsistent with the duty of loyalty an investment-adviser fiduciary is required to exercise toward clients."<sup>9</sup> And, indeed, the Department concluded that, absent regulation, these conflicts of interest in the market for IRA advice would cost investors tens of billions of dollars over the next ten years.<sup>10</sup>

In allowing class exemptions for advisers to engage in these prohibited transactions, the Department was statutorily obligated to provide investor protections sufficient for it to find that each PTE is in the best interest of IRA owners – notwithstanding the conflicts of interest it permits.<sup>11</sup> The Department fulfilled this mandate by conditioning the PTEs on adherence to the ICSs.<sup>12</sup> The ICSs are substantive standards of conduct, which require investment-advice fiduciaries to act in the best interest of their clients, receive only reasonable compensation, and refrain from making misleading statements.<sup>13</sup> Thus, although the structure of the transactions covered by these PTEs creates an incentive for investment-advice fiduciaries to act contrary to the interests of their clients, adherence with the ICSs requires them to overcome this impulse and provide advice consistent with the clients' interests.

But the ICSs are, of course, not self-enforcing. To incentivize adherence with them, the Department, therefore, conditioned the PTEs on compliance with additional measures – the Conditions – such as the adoption of policies and procedures designed to mitigate conflicts of interest, disclosure of identified conflicts, and certain representations and warranties. In the IRA market, the most important of the Conditions, however, is the Contract Condition, which requires financial institutions to represent in a written contract with investors that their investment-adviser fiduciaries will adhere to the ICSs. If an investment-adviser fiduciary violates one of the ICSs, the investor can sue for breach of contract. Because the Department is not authorized to enforce compliance with any conditions of a PTE to the prohibited transaction provisions in the Code – which cover advice with respect to IRAs – the Contract Condition represents the sole effective means of enforcing the ICSs.

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<sup>9</sup> Letter from NELP to U.S. Dep't of Labor 2 (July 21, 2017), *available at* <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00273.pdf>.

<sup>10</sup> Fiduciary Rule, 81 Fed. Reg. 20947, 20950 (Apr. 8, 2016).

<sup>11</sup> *See* 26 U.S.C. § 4975(c)(2).

<sup>12</sup> *See, e.g.,* Best Interest Contract Exemption, 81 Fed. Reg. at 21076-78 ("Section II – Contract, Impartial Conduct and Other Requirements").

<sup>13</sup> *See, e.g., id.* at 21077.

Given the extent to which investment-adviser fiduciaries currently rely on the PTEs to continue to engage in otherwise prohibited transactions, their adherence to the ICSs is of vital importance to NELP's constituents. We are gravely concerned that the delay of the Conditions contemplated by the Department will allow large numbers of investment-adviser fiduciaries to disregard the ICSs and continue to put their own interests ahead of those of their clients.

#### The Department's Regulatory Impact Analysis Fails to Account for the Costs of Delay

The Department's current regulatory impact analysis fails to adequately measure the risk of non-compliance with ICSs and thus grossly underestimates the true cost of the proposed amendments. Its assumption that most investment-adviser fiduciaries will adhere to the ICSs in the absence of any meaningful compliance mechanism is unsupported and unsupportable. Indeed, the assumption directly conflicts with the Department's prior conclusion that "the exemption's enforceability, and the potential for liability, are critical to ensuring adherence to the exemption's stringent standards and protections, notwithstanding the competing pull of the conflicts of interest associated with the covered exemption structures."<sup>14</sup>

Under the APA, an agency's reversal of position is arbitrary and capricious unless accompanied by a reasoned analysis supporting the change.<sup>15</sup> Here, the Department fails to explain why the protection afforded by the Contract Condition, which it once regarded as key to the prevention of investor losses, will not be needed until the middle of 2019.

##### *A. The Risk to IRA Investors from Conflicted Advice Has Not Diminished*

To begin with, it should be clear that risk facing investors from conflicted IRA advice is just as serious as it was in 2016. The Department heralds the development of new products, such as "T-shares" and "clean shares," that may reduce the incentive for advisers to recommend them over potentially better alternatives.<sup>16</sup> But these products are not yet widely available,<sup>17</sup> and, more importantly, their further development and distribution is *dependent* on meaningful application of the ICSs. The reason these products are under consideration in the first place is to allow investment-adviser fiduciaries to continue to receive conflicting compensation without violating the ICSs. To the extent the Department views product innovation as a basis for weakening the ICSs – which removing their sole effective enforcement mechanism would do – it has the relationship exactly backwards.

##### *B. The Department Fails to Justify its Change of Position about the Importance of the Contract Condition*

The bigger problem with the Department's analysis, however, is its supposition that the investor gains expected to accrue from Fiduciary Rule and PTEs would be "largely protect[ed]" notwithstanding the proposed delay.<sup>18</sup>

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<sup>14</sup> Best Interest Contract Exemption, 81 Fed. Reg. at 21021.

<sup>15</sup> See *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57 (1983).

<sup>16</sup> See, e.g., NPRM at 20.

<sup>17</sup> See Aron Szapiro and Paul Ellenbogen, *Why Investors Need Regulators to Promote 'Clean' Mutual Funds*, Morningstar, Sept. 13, 2017, <http://news.morningstar.com/articlenet/article.aspx?id=824886>.

<sup>18</sup> NPRM at 26.

This position is the opposite of the Department’s conclusion in 2016 that the Contract Condition provided “critical” protection to investors.<sup>19</sup> The Department concluded that the threat of civil liability created by the Condition serves as a “powerful incentive” for fiduciaries to comply with the ICSs.<sup>20</sup> And it implied that the enforcement enabled by the Contract Condition was necessary for the Secretary of Labor to make the findings statutorily required before the promulgation of any new PTE.<sup>21</sup> These findings include that the PTE protects the interests of IRA owners.<sup>22</sup>

At least with respect to IRAs, the Department offers no coherent basis for rejecting its prior assessment. To be sure, the Department claims that comments indicate that “many financial institutions already have completed or largely completed work to establish policies and procedures necessary to make many of the business structure and practice shifts necessary to support compliance with the [ICSs].”<sup>23</sup> The Department provides no examples of these comments and does not attempt to quantify of what percentage of IRA-advising investment-adviser fiduciaries these “many” institutions comprise. But even taking the assertion at face value, the Department fails to account for the obvious fact that developing and implementing policies are two different things, and that it is the implementation, not the development, of policies that protects investors. Moreover, the Department glosses over the fact that these “structure and practice shifts” have occurred in the shadow of the Contract Condition’s January 1, 2018, applicability date. To remove the threat of enforcement, as the Department does with its proposed delay, is to remove the incentive to change business practices. And, in fact, the absence of any liability exposure for violations of the ICSs is likely to lead to significant backsliding. Gone would be the threat of sanction for acting on conflicts of interest, while the profit motive to act on these conflicts would remain. Finally, the Department’s analysis of the benefits of delay calls into question its assumption that many investment-adviser fiduciaries are, in fact, likely to adhere to the ICSs. If industry compliance were as likely to occur during a delay as the Department believes it would be, it is strange that the Department expects the delay to save financial institutions so much money on compliance costs.<sup>24</sup>

That the Department purports to rely on the Code’s excise tax provisions as an alternative ICS-enforcement mechanism<sup>25</sup> only further undermines its current analysis. As the Department well knows, the excise tax provides little or no incentive to comply with PTE conditions. First, it is administered by the resource-strapped IRS,<sup>26</sup> not the Department. Second, the extent of the tax is limited to the proceeds of the fiduciary’s violations – so, at worst, a violator breaks even. And third, the tax provision does not even provide authority for the

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<sup>19</sup> See, e.g., *id.* at 21008 ; *id.* at 21021; *id.* at 21033.

<sup>20</sup> See *id.* at 21021; *id.* at 21022; *id.* at 21024.

<sup>21</sup> See *id.* at 21060.

<sup>22</sup> See 26 U.S.C. § 4975(c)(2).

<sup>23</sup> NPRM at 25.

<sup>24</sup> See *id.* at 28 (“[T]he Department estimates the ten-year present value of the cost savings of firms not being required to incur ongoing compliance costs during an 18 month delay would be [between \$2.2 billion and \$2.0 billion, depending on discount rate].”

<sup>25</sup> *Id.*

<sup>26</sup> See, e.g., Brandon Debot, Emily Horton & Chuck Marr, Ctr. on Budget and Policy Priorities, *Trump Budget Continues Multi-Year Assault on IRS Funding Despite Mnuchin’s Call for More Resources* (2017) <https://www.cbpp.org/research/federal-budget/trump-budget-continues-multi-year-assault-on-irs-funding-despite-mnuchins>.

government to investigate or audit compliance. Enforcement depends solely on *self*-reporting. To quote the Department: “Without a contract, the possible imposition of an excise tax provides an additional *but inadequate* incentive to ensure compliance with the exemption’s standards-based approach.”<sup>27</sup> To quote it further: “This is particularly true because imposition of the excise tax critically depends on fiduciaries’ self-reporting of violations, rather than independent investigations and litigation by the IRS.”<sup>28</sup> The notion that the threat of an excise tax will ensure adherence with the ICSs simply cannot be credited.

### C. *The Department Fails to Quantify the Costs of Delay*

Without evidence to suggest that the risks associated with conflicted investment advice have been reduced in the past year-and-a-half, or that the Contract Condition is no longer a critical safeguard against these risks, the true cost of delay is likely to be substantial. Tellingly, however, the Department does not attempt to quantify it. Instead, the Department simply predicts that any investor losses caused by the delay are likely to “relatively small.”<sup>29</sup> A final rule for which the Department failed to calculate the costs of the proposed delay, while relying on its benefits, would be arbitrary and capricious.<sup>30</sup>

The Economic Policy Institute (“EPI”) has used data previously embraced by the Department to quantify the likely costs of delay, and they are not by any definition, “relatively small.” EPI estimates that an eighteen-month delay of the Conditions will cost investors between \$5.5 and \$16.3 billion over 30 years.<sup>31</sup> EPI’s methodology is based on research by the White House Council of Economic Advisers that indicates that conflicted advice costs investors at least 100 basis points a year in lost returns.<sup>32</sup> These losses compound over the life of an investment and so, even assuming that 75% of all IRA advice over the delay period is provided consistent with the ICSs, EPI estimates that investors will still lose \$5.5 billion over 30 years.<sup>33</sup> If compliance with the ICSs falls to 25%, which is plausible given the absence of effective enforcement, the losses mount to \$16.3 billion.<sup>34</sup> A fifty- percent compliance rate yields \$10.9 billion in losses.<sup>35</sup>

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<sup>27</sup> Best Interest Contract Exemption, 81 Fed. Reg. at 21022 (emphasis added).

<sup>28</sup> *Id.*

<sup>29</sup> See NPRM at 23.

<sup>30</sup> See *Competitive Enter. Inst. v. NHTSA*, 956 F.2d 321, 326-27 (D.C. Cir. 1992); cf. *Ctr. for Biological Diversity v. NHTSA*, 538 F.3d 1172, 1200 (9th Cir. 2008) (holding that the existence of range of possible costs does not excuse an agency from calculating the costs, at least when the costs are not zero).

<sup>31</sup> Letter from EPI to U.S. Dep’t of Labor (Sept. 11, 2017), available at <http://www.epi.org/publication/epi-comment-on-the-proposed-18-month-delay-of-key-provisions-of-the-fiduciary-rule/>.

<sup>32</sup> EPI, Methodology for Estimating Losses to Retirement Investors of Partial Implementation of Fiduciary Rule, <http://www.epi.org/publication/methodology-for-estimating-losses-to-retirement-investors-of-partial-implementation-of-fiduciary-rule-2/>.

<sup>33</sup> See *id.*

<sup>34</sup> See *id.*

<sup>35</sup> See *id.*

If the Department decides to perform its own quantitative analysis of the costs of delay, it cannot, consistent with the APA, simply release its calculations with a final rule. Rather, the Department would need to publish any such analysis for public comment on its underlying methodology.<sup>36</sup>

#### The True Costs of Delay Far Outweigh Any Benefits from Saved and Deferred Compliance Costs

Investor losses on the scale just described dwarf the cost of compliance with the Contract Condition. Responding to stakeholder comments, the Department clarified in the final form of the Best Interest Contract Exemption that the Contract Condition may be satisfied in a variety of straightforward ways.<sup>37</sup> A representation of adherence to the ICSs may be included in: “an investment advisory agreement, investment program agreement, account opening agreement, insurance or annuity contract or application, or similar document, or amendment thereto.”<sup>38</sup> For existing clients, the Condition may be satisfied through negative consent,<sup>39</sup> and, of course, a single representation in a master agreement will satisfy the Condition for all recommendations between an investment-adviser fiduciary and a client.<sup>40</sup> The import of all of this is that it should be exceedingly easy for financial institutions to comply with the Contract Condition. For existing clients, the institutions need only send an amended version of an existing contract, which, unless canceled, will become automatically effective after 30 days.<sup>41</sup> With respect to new clients, financial institutions can simply add the representation – a few short words – to their standard advisory or account-opening agreement.

The extremely small cost of compliance with the Contract Conditions makes us wonder whether the true “costs” of which many in industry complain is exposure to liability for violations of the ICSs – contrary to the Department’s stated assumption of near-total compliance with them. But such expense cannot be properly considered a cost since it represents merely a transfer of income from financial institutions to investors to compensate investors for losses caused by illegal conduct. And, as explained above, it is the threat of these very outlays that best ensures adherence to the ICSs.

#### Conclusion

For the foregoing reasons, NELP opposes any further delay to any of the Conditions.

Sincerely,



Christine L. Owens  
Executive Director

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<sup>36</sup> See 5 U.S.C. § 553 (b)(3) and Exec. Order No. 12866 §1(b)(6).

<sup>37</sup> See Best Interest Contract Exemption, 81 Fed. Reg. at 21024.

<sup>38</sup> *Id.* at 21023.

<sup>39</sup> *Id.*

<sup>40</sup> See *id.* at 21024.

<sup>41</sup> *Id.* at 21023.